MTDC

Annual Report

1998

MTDC

The First Twenty Years

In October 1998 the Massachusetts Technology Development Corporation (MTDC) celebrated its 20th Anniversary. Twenty years ago, the Commonwealth of Massachusetts adopted an economic development strategy that capitalized on its technology talent base. MTDC was assigned the objective of helping to finance technology start-up companies that could attract private co-investment and create new jobs. Through November 1998, the Corporation has invested in 90 firms and helped to build companies that collectively employ more than 8,600 people.

In many respects, MTDC began and grew just like the start-up companies it backs. It was launched as a concept with a modest operating budget from the State and $3 million in investment capital from the Federal Government. The Commonwealth then added a total of $5.2 million in investment funds from FY81 to FY88. Since FY88, the returns from successful investments have enabled MTDC to self-finance its operations and increase its total assets to $27.6 million.

Today, the Corporation continues its unique and primary mission of addressing the "capital gap" experienced by seed and early-stage technology companies seeking investment funds. MTDC's investment focus is on these enterprises, through which it seeks to accomplish the following objectives:

- to help create primary employment in Massachusetts;
- to attract and leverage private investment in these companies;
- to foster the application of technological innovations through which these firms are, or can be, market leaders; and
- to nurture entrepreneurship among Massachusetts' citizens, planting the seeds for long-term economic development in the Commonwealth.

In addition, MTDC has achieved investment returns that are commensurate with the risks associated with seed and start-up stage companies, and with the length of time required to achieve successful harvests. Our experience is that the most rewarding harvests do not occur until 7 to 10 years after initial investment. We are pleased to report that through June 30, 1998, the internal rate of return on the entire portfolio since 1980 was 17.7%. This result compares favorably with the expected rate of return for seed and start-up venture capital funds.

Fiscal Year 1998

In this Annual Report, we highlight FY98's accomplishments and outline MTDC's future plans.

Investments

During FY98, MTDC invested $3,243,247, bringing cumulative investments since FY80 to $34,981,825 among a total of 87 companies. The FY98 investments were as follows:

FOUR NEW INVESTMENTS FROM THE MTDC TRADITIONAL FUND:

Andover Advanced Technologies of Acton
Courion Corporation of Natick
Global Telemedix of Westford
Universal Learning Technology of Peabody

TEN FOLLOW-ON INVESTMENTS WITHIN THE EXISTING PORTFOLIO

FOUR INVESTMENTS FROM THE COMMONWEALTH FUND INVESTMENT PROGRAM:

CytoLogix Corporation of Cambridge
Global Telemedix of Westford
MicroE of Natick
VenturCom of Cambridge

Investment Returns

As of June 30, 1998, MTDC had exited, or begun to exit, its investments in 60 of its 87 portfolio companies. During FY98, MTDC's record realized gains totaled $11,454,538. Realized losses totaled $2,157,500. Cumulative gains on equity investments since 1980 were $32,502,206, while cumulative losses on both debt and equity investments were $10,049,256, for total net gains of $22,452,950.

Investment Capital

While MTDC's initial capital came from federal and state grants, the Corporation uses gains realized from past investments as the primary source of funds for current and future investments. The following summarizes the investment capital sources as of June 30, 1998:

Restricted for Investment Fund:	
Economic Development Administration of the US Department of Commerce	$ 2,972,000
Commonwealth of Massachusetts	5,200,000
Gains on previous MTDC investments	21,570,696
Subtotal	$ 29,742,696
General Support Fund:	
Gains allocated for SSBIC	$ 600,000
PRIT Fund	$ 2,000,000
Commonwealth Fund Co-Investors	$ 2,000,000
Total Funds Under Management	$ 34,342,696

MTDC Commonwealth Fund Investment Program

Beginning in FY96, MTDC initiated the Commonwealth Fund Investment Program with a $5,000,000 investment pool. MTDC committed $3,000,000, and $1,000,000 each was committed by BancBoston Investments, Inc. and Fleet Growth Resources, Inc. In FY98, the Corporation closed Commonwealth Fund investments totaling $889,174 in 5 companies, bringing the cumulative investments of the Program to $2,582,845 in 9 companies.

During FY98, one of the companies in which the Program had invested was acquired, and this exit resulted in realized gains to the Program. The pro rata shares of these gains were distributed to MTDC and the bank co-investors. In addition, the Commonwealth of Massachusetts General Fund received $201,166, or 20% of the net realized gains that MTDC earned from the Commonwealth Fund.

Economic Benefits

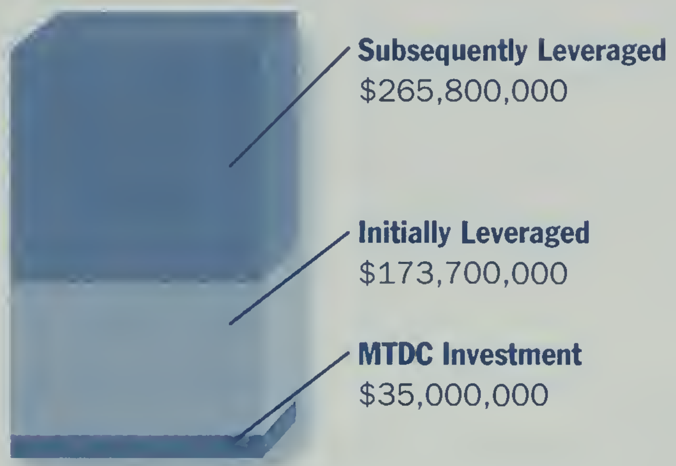
The principal objective of MTDC's Investment Program has been to assist early-stage technology companies start and/or expand in the State by commercializing technology developed in local corporations and research institutions. In this way, the Corporation helps to replenish the supply of new technology businesses whose growth in employment helps offset the inevitable decline among mature technology companies. These new Massachusetts firms become aggressive competitors in the global marketplace very early in their life cycles.

These early-stage companies provide significant employment growth opportunities and long-term value to the Massachusetts economy. As of December 31, 1997, the companies in which MTDC had invested reported that they employed in total more than 8,600 people. This employment generated a reported annual payroll of over $431 million, federal tax revenue of over $131.2 million and state tax revenue of over $19.6 million.

Employment
Total Annual Payroll: $431,000,000

Another important measure of economic benefit to the Commonwealth is the amount of private capital that MTDC's investments have helped to leverage. As of June 30, 1998, MTDC's cumulative investments of $35 million had initially leveraged $173.7 million. In subsequent rounds of investment where MTDC did not participate, the portfolio companies raised an additional $265.8 million. The cumulative total investments were $474.5 million.

Investment Dollars
Total Investment: $474,500,000



In addition to its Investment Program, MTDC provides management assistance to Massachusetts early-stage technology companies. The entrepreneurs launching these firms are usually experienced technologists, but inexperienced business people. Therefore, MTDC's Management Assistance Program focuses on strategies to increase the visibility and successful presentation of these companies to potential investors.

Future Developments

During FY98, MTDC harvested record realized gains. The funds provided from these harvests will continue to support the Corporation's operating expenses and replenish the Investment Fund. However, the impact of inflation alone over the past 20 years makes it imperative to plan to commit more funds to each portfolio company. This necessitates that the Corporation secure additional investment capital.

The Commonwealth Fund Investment Program previously mentioned serves as a prototype for the way MTDC will offer future opportunities to potential co-investors to participate in growing new technology enterprises in the Commonwealth while seeking superior financial returns. We expect to use this model to raise additional complementary capital for MTDC to invest on behalf of these co-investors.

In order to enhance MTDC's ability to raise additional private investment capital, as well as update and modernize its 20-year-old charter, the Corporation has filed legislation to modify its enabling act. We hope this bill will be passed and signed into law during the next session of the Legislature.

MTDC Board of Directors

During FY98, Christopher Alberti resigned from the Board after serving for over four years. We appreciate his contributions to the success of MTDC.

In recent months, the Governor has appointed Dr. Frank Manning, President of Zoom Telephonics, and Alan Morse, Jr., Chairman of the Board of Directors of Harvard Pilgrim Health Care, to fill two vacancies on the MTDC Board. We welcome them and appreciate their willingness to contribute to MTDC.

We also want to thank all Board members for providing their knowledge, experience, skill and wisdom as a *pro bono publico* service. In addition to the overall governance of the Corporation, the Board plays a critical role in reviewing and approving each investment action.

Conclusion

MTDC has consistently played a unique role among the economic development organizations of the Commonwealth. By steadily pursuing its long-term investment strategy, MTDC will continue to successfully serve its shareholders, the citizens of the Commonwealth, into the next century.

Sincerely,

Paul J. Severino
Chairman

John F. Hodgman
President

PricewaterhouseCoopers LLP
One International Place
Boston, MA 02110
Telephone (617) 478 5000
Facsimile (617) 478 3900

To the Board of Directors of Massachusetts Technology Development Corporation:

In our opinion, the accompanying balance sheets and the related statements of revenues, expenses, and changes in fund balances, and of cash flows present fairly, in all material respects, the financial position of Massachusetts Technology Development Corporation at June 30, 1998 and 1997, and the results of its operations and its cash flows for the years then ended in conformity with generally accepted accounting principles. These financial statements are the responsibility of the Corporation's management; our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits of these statements in accordance with generally accepted auditing standards which require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. Our procedures included verification of investments owned as of June 30, 1998 and 1997, by examination of securities. We believe that our audits provide a reasonable basis for the opinion expressed above.

As discussed in Notes 2 and 12 to the financial statements, in 1998 Massachusetts Technology Development Corporation changed its method of accounting for certain investments in accordance with Statement of Governmental Accounting Standards Board No. 31. These changes were applied retroactively and the financial statements for the year ended June 30, 1997 have been restated.

PricewaterhouseCoopers LLP

July 31, 1998

Balance Sheets

June 30, 1998 and 1997

ASSETS	1998	1997
GENERAL SUPPORT:		
Cash, cash equivalents and short-term investments (Note 4)	**$ 1,447,744**	$ 235,832
Interest receivable	**83,000**	33,000
Other receivables	**46,462**	13,688
Prepaid expenses and deposits	**54,646**	21,711
Investment in licensed SSBIC (Note 5)	**600,000**	600,000
Leasehold improvements and office equipment – at cost, less accumulated depreciation and amortization of $251,262 in 1998 and $220,387 in 1997 (Note 6)	**42,026**	49,694
Restricted cash, cash equivalents and short-term investments (Notes 4 and 8)	**3,090,424**	719,655
Total general support	**5,364,302**	1,673,580
RESTRICTED FOR INVESTMENT PROGRAMS:		
Cash, cash equivalents and short-term investments (Note 4)	**7,235,652**	1,468,883
Investments (Notes 2 and 3):		
At cost	**11,436,631**	12,764,673
Unrestricted publicly traded, at market (cost of $1,021,158 in 1998 and $648,889 in 1997)	**3,555,763**	806,903
Total investments	**14,992,394**	13,571,576
Total restricted for investment programs	**22,228,046**	15,040,459
TOTAL ASSETS	**$27,592,348**	$16,714,039

LIABILITIES AND FUND BALANCES		
GENERAL SUPPORT:		
Accrued liabilities	**1,118,854**	73,349
Commitments and contingencies (Notes 3 and 9)		
Fund balance	**4,245,448**	1,600,231
Total general support	**5,364,302**	1,673,580
RESTRICTED FOR INVESTMENT PROGRAMS – fund balance (Notes 3 and 12)	**22,228,046**	15,040,459
TOTAL LIABILITIES AND FUND BALANCES	**$27,592,348**	$16,714,039

The accompanying notes are an integral part of the financial statements.

Statements of Revenues, Expenses, and Changes in Fund Balances

for the years ended June 30, 1998 and 1997

	1998 General Support	1998 Restricted for Investment Programs	1997 General Support	1997 Restricted for Investment Programs
REVENUES:				
Realized gains on equity investments	**$11,454,538**		$ 145,770	
Unrealized net change in portfolio value		**$ 2,376,592**		$ 55,374
Interest	**297,564**		322,984	
Dividends	**13,460**			
Management fees (Notes 3 and 11)	**77,109**		36,667	
Miscellaneous			6,508	
Total revenues	**11,842,671**	**2,376,592**	511,929	55,374
EXPENSES:				
General support (Note 7)	**2,228,959**		1,125,350	
Realized losses on investments		**(2,157,500)**		(1,243,943)
Excess (deficiency) of revenues over expenses	**9,613,712**	**219,092**	(613,421)	(1,188,569)
Interfund transfers (Notes 3 and 8)	**(6,968,495)**	**6,968,495**	(1,172,000)	1,172,000
Fund balances, beginning of year (Note 12)	**1,600,231**	**15,040,459**	3,385,652	15,057,028
Fund balances, end of year	**$ 4,245,448**	**$22,228,046**	$1,600,231	$15,040,459

The accompanying notes are an integral part of the financial statements.

Statements of Cash Flows

for the years ended June 30, 1998 and 1997

	1998 General Support Unrestricted	1998 General Support Restricted	1998 Restricted for Investment Programs	1997 General Support Unrestricted	1997 General Support Restricted	1997 Restricted for Investment Programs
CASH FLOWS FROM GENERAL SUPPORT ACTIVITIES:						
Excess (deficiency) of revenues over expenses	$ 9,613,712			$(613,421)		
Adjustments to reconcile excess (deficiency) of revenues over expenses to cash used for General Support and Restricted for Investment programs activities:						
Gains on sales of investments	(11,454,538)			(145,770)		
Gains on disposal of assets				(1,783)		
Depreciation and amortization	30,875			31,330		
Increase (decrease) in cash from:						
Interest receivable	(50,000)			(878)		
Other receivables	(32,774)			12,344		
Prepaid expenses and deposits	(32,935)			2,545		
Accrued liabilities	1,045,505			(62,769)		
Total adjustments	(10,493,867)			(164,981)		
Cash used for General Support activities	(880,155)			(778,402)		
CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITY: Interfund transfer	(9,339,264)	$2,370,769	$6,968,495	508,345	$(1,680,345)	$1,172,000
CASH FLOWS FROM CAPITAL ACTIVITIES:						
Purchase of office equipment	(23,207)			(18,045)		
Disposal of office equipment				2,145		
Cash used for capital activities	(23,207)			(15,900)		
CASH FLOWS FROM RESTRICTED FOR INVESTMENT PROGRAMS ACTIVITIES:						
Purchases of investments			(3,243,247)			(2,530,902)
Proceeds of investments:						
Gains	11,454,538			145,770		
Costs recovered			1,877,353			336,309
Principal repayments			164,168			518,613
Cash provided by (used for) Restricted for Investment Programs activities	11,454,538		(1,201,726)	145,770		(1,675,980)
INCREASE (DECREASE) IN CASH, CASH EQUIVALENTS AND SHORT-TERM INVESTMENTS	1,211,912	2,370,769	5,766,769	(140,187)	(1,680,345)	(503,980)
CASH, CASH EQUIVALENTS AND SHORT-TERM INVESTMENTS, BEGINNING OF YEAR	235,832	719,655	1,468,883	376,019	2,400,000	1,972,863
CASH, CASH EQUIVALENTS AND SHORT-TERM INVESTMENTS, END OF YEAR	$ 1,447,744	$3,090,424	$7,235,652	$ 235,832	$ 719,655	$1,468,883

The accompanying notes are an integral part of the financial statements.

Notes to Financial Statements

1. Organization and Operations:

Massachusetts Technology Development Corporation (the "Corporation") was created as a body politic and instrumentality of The Commonwealth of Massachusetts (the "Commonwealth") on October 19, 1978, pursuant to Chapter 497 of the Acts of 1978. The purpose of the Corporation is to provide financial and other assistance to innovative enterprises in Massachusetts that have the potential to expand and generate new jobs and tax revenues. The Corporation is governed by a Board of Directors consisting of eleven members, eight of whom are appointed by the Governor of Massachusetts from the private sector and three of whom are public officials.

2. Summary of Significant Accounting Policies:

The financial statements of the Corporation have been prepared in conformity with generally accepted accounting principles as applied to government units. The Government Accounting Standards Board is the accepted standard setting body for establishing governmental accounting and financial reporting principles. The more significant of the Corporation's accounting policies are described below.

Fund Accounting

Proprietary funds are used to account for activities similar to those found in the private sector, where the determination of net income is necessary or useful to sound financial administration.

Basis of Accounting

All proprietary funds are accounted for on a flow of economic resources measurement focus. With this measurement focus, all assets and all liabilities associated with the operation of these funds are included in the balance sheet. Fund balances (i.e., net total assets) are segregated into General Support and Restricted for Investment Programs components. Proprietary fund-type operating statements present increases (e.g., revenues) and decreases (e.g., expenses) in net total assets.

The accrual basis of accounting is utilized for all funds. Under this method, revenues are recorded when earned and expenses are recorded at the time the related liability is incurred.

Cash and Cash Equivalents

The Corporation considers all highly liquid investments with original maturities of three months or less to be cash equivalents.

Short-Term Investments

Short-term investments are those with original maturities in excess of three months but less than one year and are valued at cost, which approximates market.

Leasehold Improvements and Office Equipment

Leasehold improvements and office equipment are stated at cost. Office equipment is being depreciated using the straight-line method over the estimated useful lives of the related assets, ranging from three to five years. Leasehold improvements are amortized on a straight-line basis over the shorter of the improvement's useful life or the term of the related lease.

Upon retirement or sale, the cost of the assets disposed and the related accumulated depreciation or amortization are removed from the accounts and any resulting gain or loss is included in the determination of the excess (deficiency) of revenues over expenses.

continued

2. Summary of Significant Accounting Policies *continued*

Investments

The Corporation's investment securities are purchased in the name of the Corporation and are maintained in a vault at a financial institution. These investments are generally in early-stage technology companies.

In 1998, the Corporation adopted Governmental Accounting Standards Board Statement No. 31 ("GASB 31"), *Accounting and Financial Reporting for Certain Investments and for External Investment Pools*. GASB 31 requires entities to carry investments at fair value if such values are readily available. Accordingly, unrestricted publicly traded securities are carried at fair value. GASB 31 requires the restatement of prior periods. The restatement of fund balances at June 30, 1996 is presented in Note 12.

Investments, consisting of notes receivable and investments in capital stock that are not publicly traded or have restrictions as to resale are recorded at cost. Investments that are publicly traded and free from trading restrictions, are valued at market value as determined by their respective stock exchange prices as of the close of trading on June 30, 1998 and 1997, respectively. In the opinion of management, the estimated aggregate fair value of total investments was in excess of cost at June 30, 1998 and 1997. Realized gains on investments are credited to the Corporation's General Support Fund Balance. Realized losses are charged against the Restricted for Investment Programs Fund Balance. Unrealized net changes in portfolio value resulting from changes in the market value of publicly traded investments at balance sheet date are credited (charged) to the Restricted for Investment Programs Fund Balance. Repayments of principal and proceeds from the sale of equity investments (to the extent of the cost basis) remain in funds restricted for investment programs. Investment interest is credited to the Corporation's General Support Fund Balance.

During the years ended June 30, 1998 and 1997, the Corporation realized gains on sales of investments totaling $11,454,538 and $145,770, respectively. During the years ended June 30, 1998 and 1997, the Corporation realized losses of $2,157,500 and $1,243,943, respectively. At June 30, 1998 and 1997, the Corporation recorded unrealized net increases in portfolio value of $2,376,592 and $55,374, respectively.

Preparation of Financial Statements

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and contingent liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting periods. Actual results could differ from those estimates.

Income Taxes

The Corporation, as an instrumentality of the Commonwealth, is not subject to federal or state income taxes.

Reclassifications

Certain reclassifications were made to the prior year's financial statements to conform to the current year's presentation.

3. Investment Program:

Sources of Funds

The Corporation's original investment funds were provided in 1979 by a $2,000,000 grant (including $28,000 in start-up costs) from the Economic Development Administration ("EDA"), U.S. Department of Commerce. Under this grant, the Corporation makes loans from a revolving loan fund to eligible borrowers, defined as Massachusetts-based businesses with operations involving a significant amount of technology, which are located in EDA Title IV redevelopment areas and which meet the requirements of the Corporation's enabling act.

During the year ended June 30, 1981, the Corporation was awarded a $1,000,000 grant under the Corporations for Innovation Development ("CID") program of the U.S. Department of Commerce. The grant award is for the purpose of establishing a second revolving loan fund to assist in the creation and development of small, innovative high-technology companies in Massachusetts. In addition, the Commonwealth appropriated $1,000,000 to the Corporation as matching funds for the federal grant. The Commonwealth appropriation is restricted to equity investments.

Each year from fiscal years 1982 to 1988, the Commonwealth appropriated additional amounts to supplement the Corporation's investment fund. Since fiscal year 1988, no such appropriations have been made. At June 30, 1998, the cumulative amount of these appropriations totaled $4,200,000.

Under the terms of the grants of investment funds from the federal government and the Commonwealth, principal repayments and costs recovered are returned to the Restricted for Investment Programs Fund to be reinvested in accordance with the criteria required by the grants' provisions and the Corporation's enabling legislation and policies. In addition, the Board of Directors of the Corporation has transferred approximately $21,570,696 cumulatively through fiscal year 1998 to the Restricted for Investment Programs Fund to be reinvested in accordance with the criteria required by the Corporation's enabling legislation and policies. The transferred funds were derived from earnings and gains realized on past investments by the Corporation.

The Board of Directors voted to transfer up to $7,222,900 and $1,400,000 from General Support funds to Restricted for Investment Program funds on an as-needed basis for the years ended June 30, 1998 and 1997, respectively. In addition, during fiscal 1997 the Directors voted to transfer up to $873,000 from the General Support Fund operating reserve to Restricted for Investment Program Funds on an as-needed basis. Actual transfers to the Restricted for Investment Programs Fund for the years ended June 30, 1998 and 1997, totaled $6,968,495 and $1,172,000, respectively.

The total funds, since inception of the Corporation, which have been made available for investments are as follows:

Economic Development Administration of the U.S. Department of Commerce, net of start-up costs		$ 2,972,000
Commonwealth of Massachusetts		5,200,000
Realized gains on sales of equity securities allocated to General Support Fund	$32,502,206	
Portion of gains used for General Support activities	(10,931,510)	
Transfers to the Restricted for Investment Programs Fund		21,570,696
Total funds made available for investment		29,742,696
Realized losses on investments		(10,049,256)
Unrealized net change in portfolio value		2,534,606
Restricted for Investment Programs Fund balance		$22,228,046

continued

3. Investment Program *continued*:

MTDC Commonwealth Fund

On July 19, 1993, Section 105 of Chapter 110, MGL Acts of 1993, was enacted which authorized the Board of Directors to establish the MTDC Commonwealth Fund. Pursuant to this Chapter, at the July 29, 1993 Board Meeting, the Board of Directors approved the allocation of $1,000,000 to establish said fund. Subsequently, during fiscal 1994, the Board of Directors voted to restrict an additional $200,000 for MTDC Commonwealth Fund investments. During fiscal 1995 the Board of Directors authorized an additional commitment of $2,100,000, bringing the Corporation's total commitment to $3,300,000. The investments made by MTDC through the Commonwealth Fund are included in the Restricted for Investment Programs Fund Balance. Pursuant to the guidelines of the Chapter, the investment criteria for funds managed under the Commonwealth Fund are less restrictive than for the Corporation's traditional programs.

Also pursuant to this Chapter, the Corporation undertook an effort to seek co-investors through its Commonwealth Fund Investment Program (the "Program"). During fiscal 1995, two financial institutions agreed to participate in the Program, committing $1,000,000 each. Funds received in advance from co-investors are separately maintained and these funds are not included in MTDC's Restricted for Investment Programs Fund Balance.

The Corporation manages the Program and receives a management fee and a residual interest in the investments of the Program. In fiscal 1998 and 1997, the Corporation earned $40,000 and $36,667, respectively, in management fees.

Pursuant to an agreement dated September 26, 1994, between the Corporation and The Commonwealth of Massachusetts, a share of the net realized gains from the Corporation's investments in the Commonwealth Fund shall be distributed to the General Fund of The Commonwealth of Massachusetts. During fiscal year 1998, one of the Commonwealth Fund's investee companies, Interactive Video Systems, Inc., was acquired by Schlumberger Technology Corporation resulting in a net realized gain to the Corporation of $1,005,831. Accordingly, at June 30, 1998, $201,166, or 20% of the net realized gain, is included in accrued liabilities. On July 14, 1998, the Corporation made a distribution in the same amount to The Commonwealth of Massachusetts.

Investments

During the years ended June 30, 1998 and 1997, the Corporation made loans and equity investments in aggregate amounts of $3,243,247 and $2,530,902, respectively. The notes in the portfolio have interest rates varying from 8% to 13% per year. The terms of certain notes include an equity participation feature such as rights to convert to stock at a predetermined price or warrants to purchase common stock. Repayment of principal is generally due on demand, in a balloon payment, or in monthly installments ranging from thirty-six to sixty months. Such principal payments, however, are generally subordinated to the payment of senior debt of the borrowers.

A summary of investment activity is as follows:

	Notes Receivable	Equity Investments	Total
Investments made:			
1980 through 1996	$16,651,527	$12,556,149	$29,207,676
1997	1,200,466	1,330,436	2,530,902
1998	1,793,240	1,450,007	3,243,247
Total investments	19,645,233	15,336,592	34,981,825
Conversions of loan principal to equity	(7,956,301)	7,956,301	—
Less loan principal repayments and equity investment cost recovered	(6,369,397)	(6,105,384)	(12,474,781)
Realized gains on sales of equity securities - 1982 through 1998		32,502,206	32,502,206
Allocation of realized gains to General Support Fund		(32,502,206)	(32,502,206)
Realized losses on investments:			
1983 through 1996	(2,133,341)	(4,514,472)	(6,647,813)
1997	(398,200)	(845,743)	(1,243,943)
1998	(252,970)	(1,904,530)	(2,157,500)
Total realized losses	(2,784,511)	(7,264,745)	(10,049,256)
Unrealized net change in portfolio value		2,534,606	2,534,606
Investment Balance, June 30, 1998	$ 2,535,024	$12,457,370	$14,992,394

As of June 30, 1998, the investment portfolio consisted of the following types of securities as a percentage of the General Support and Restricted for Investment Program Fund Balances ("Fund Balance"): Common stock 17.9%, preferred stock 28.9%, convertible debt 1.4%, notes 7.8%, and other .6%. At June 30, 1998, no investment in any one Company represented more than 5% of the Fund Balance except Picturetel Corporation, which was 11.6% of the Fund Balance.

As of June 30, 1998 and 1997, there were outstanding commitments for loans and equity investments totaling $575,000 and $777,000, respectively. In addition, the Corporation had guaranteed bank loans totaling $173,000 as of June 30, 1997. There were no guaranteed bank loans at June 30, 1998.

continued

4. Cash, Cash Equivalents and Short-Term Investments:

The Corporation maintains operating cash accounts and other short-term investment securities to fund operations and provide appropriate reserves for the Corporation's investment programs. The Corporation's short-term investment securities include certificates of deposit, money market accounts, banker's acceptances, commercial paper, treasury bills, and government agencies.

As of June 30, 1998, the carrying amount of all of the Corporation's cash, cash equivalents and short-term investments totaled $11,773,820, all held in financial institutions. Of that total, approximately $467,608 was insured, $1,976,610 was collateralized, and $9,329,602 was uninsured and uncollateralized. Of the uninsured and uncollateralized portion, approximately $1,943,534 was held in direct obligations of the U.S. Treasury, $3,000,110 was held in indirect obligations of the U.S. Government, $1,383,941 was on deposit with the Massachusetts Municipal Depository Trust, and $3,002,017 was on deposit with various leading local and national banks.

5. Investment in Licensed SSBIC:

As directed by Chapter 19 of the Acts of 1993, a $600,000 commitment for 26% ownership in a licensed SSBIC (Specialized Small Business Investment Corporation), is presented separately on the balance sheet. This investment is accounted for using the cost method. To date, management believes there has been no impairment of this investment.

6. Leasehold Improvements and Office Equipment:

	1998	1997
Office equipment	**$280,002**	$256,795
Leasehold improvements	**13,286**	13,286
Total	**293,288**	270,081
Less accumulated depreciation and amortization	**251,262**	220,387
Leasehold improvements and office equipment	**$ 42,026**	$ 49,694

7. General Support Expenses:

The General Support expenses for the years ended June 30, 1998 and 1997 were as follows:

	1998	1997
THE CORPORATION'S PROGRAMS:		
Personnel costs	**$1,674,213**	$ 855,504
Professional expenses	**76,158**	42,620
Occupancy costs	**114,614**	90,054
Office services and supplies	**80,335**	69,434
Travel, meetings and conferences	**35,330**	28,967
Publications and advertising	**15,290**	18,343
Miscellaneous	**11,025**	10,204
Subtotal expenses	**2,006,965**	1,115,126
Commonwealth Fund Distribution to General Fund (Note 3)	**201,166**	—
Jointly sponsored programs – Quasi-public Corporation Planning Council projects	**20,828**	10,224
Total expenses	**$2,228,959**	$1,125,350

During the year ended June 30, 1998, the Board of Directors approved the establishment of a Gain Share Award Plan. The Plan is designed to encourage long-term retention of staff members by creating financial incentives including retirement plan funding. Under the Plan, up to 20% of the Corporation's fiscal year net realized gains can be made available for award. Actual fiscal year 1998 gain share awards totaled approximately $670,400, or approximately 7.2% of net realized gains, and is included in personnel costs. Payment of gain share awards is limited by total cash compensation maximums established for specific positions for the fiscal year. Current year gain share awards that exceed total cash compensation maximums are reserved for distribution in subsequent years. Approximately $58,700 of the total fiscal year 1998 gain share award pool will be paid out in fiscal year 1999. The balance, approximately $611,700, has been reserved to be paid out over a period of years ending with fiscal year 2002. The Plan provides for forfeiture penalties should a staff member leave the employ of the Corporation before the end of this period. The final implementation of the Plan is contingent upon the filing of legislation that modifies the charter of the Corporation.

8. Restricted Cash - General Support:

During the year ended June 30, 1997, $508,345 of the General Support operating reserves was used for operations. Also during fiscal 1997, $1,172,000 was transferred from the General Support funds restricted for certain investment-related activities to the Restricted for Investment Programs Fund. The ending balances for the General Support operating reserves and funds restricted for certain investment-related activities at June 30, 1997 were $491,655 and $228,000, respectively.

continued

8. Restricted Cash - General Support *continued*

During the year ended June 30, 1998, $447,317 of the General Support operating reserves was transferred to the Restricted for Investment Programs Fund, and $44,338 was used for operations. Also during fiscal 1998, $228,000 was transferred from the General Support funds restricted for certain investment-related activities to the Restricted for Investment Programs Fund. In addition, the Board of Directors voted to re-establish a General Support operating reserve of $1,200,000 to be used to offset possible shortfalls in revenue because the timing of the realization of gains on investments is not precisely manageable nor predictable. Further, the Board of Directors voted to restrict $1,100,000 of General Support funds for certain investment-related activities. The ending balances for the General Support operating reserves and funds restricted for certain investment-related activities at June 30, 1998 were $1,200,000 and $1,100,000, respectively.

Also during fiscal 1998, the Board of Directors voted to restrict General Support funds to establish a Gain Share Award Plan (Note 7), a Post-Retirement Health and Dental Insurance Plan, and a Retirement Incentive Plan. There were no actual disbursements for any of these plans as of June 30, 1998. The ending balances for the Gain Share Award Plan Reserve, Post-Retirement Health and Dental Insurance Plan Reserve, and Retirement Incentive Plan Reserve at June 30, 1998 were $670,424, $70,000 and $50,000, respectively.

The Post-Retirement Health and Dental Insurance Plan is designed to provide post-retirement health care benefits to all employees who retire from the Corporation on or after attaining age 59 1/2 and who have been employed continuously by the Corporation, and/or its predecessor organization, the Massachusetts Science and Technology Foundation, for a combined total of at least 20 years. The Corporation will pay a portion of the premiums for health and dental insurance plans of the retiree's choice. Expenditures for post-retirement health care benefits will be recognized when paid and/or accrued but not yet paid. There were no actual disbursements or expenses recognized during fiscal year 1998. The Plan will be funded through a reserve established by the Corporation and related interest income. Premium payments are limited by the amount of funding reserved by the Corporation, precluding any unfunded liability under the Plan. The initial funding commitment is $210,000, of which $70,000 has been reserved in fiscal year 1998.

The Board of Directors has authorized a one-time Retirement Incentive Plan for employees of the Corporation who are 65 years of age or older, have more than 20 years of continuous service with the Corporation, and/or its predecessor organization, the Massachusetts Science and Technology Foundation, and who retire in calendar year 1998. Currently, two employees meet those eligibility requirements. During fiscal year 1998, the Corporation fully funded the necessary reserve of $50,000. There were no actual disbursements or expenses recognized during fiscal year 1998.

9. Office Facility Lease:

The Corporation has a lease commitment for office space extending through May 31, 2002. The agreement provides for base rent plus operating expenses and tax escalation clauses. Rent expense for the years ended June 30, 1998 and 1997 was approximately $104,063 and $75,160, respectively.

Future minimum lease payments are as follows:

1999	$104,063
2000	104,525
2001	109,613
2002	100,478
	$418,679

10. Employee Retirement Plan:

The Corporation provides retirement benefits for substantially all employees through a simplified employee pension plan ("SEPP"). The Corporation makes contributions to individual retirement accounts ("IRAs") of employees in amounts equal to 15% of an employee's gross annual salary, not to exceed the maximum amount allowable by federal law. Quarterly contributions are distributed to the eligible employee's IRA at Fidelity Investments. The Corporation has no fiduciary responsibility for these investments. Contribution expense for 1998 and 1997 approximated $129,421 and $103,910, respectively.

11. Management Fee Income:

The Corporation has an agreement with the Pension Reserves Investment Trust ("PRIT"), a Massachusetts state employee pension trust, whereby the Corporation provides investment advisory and management services relative to $2 million of PRIT assets. Pursuant to the agreement, the Corporation is entitled to receive 20% of all distributions after the original contribution to its investment account of $2 million and the cumulative management fees of $492,000 paid to the Corporation have been returned to PRIT. As of June 30, 1998, cumulative distributions returned to PRIT totaled approximately $2,677,547, including $1,352,059 gains on investments, $53,223 interest and dividends, and $1,272,265 cost recovery.

During 1998, the Corporation distributed a total of $185,547 in cumulative excess returns to PRIT, and recognized management fee income of $37,109, or 20% of the cumulative excess returns. This agreement expires on March 31, 1999.

12. Reconciliation of Restricted for Investment Programs Fund Balance:

The Restricted for Investment Programs fund balance at June 30, 1996 has been restated to reflect the adoption of the Governmental Accounting Statement No. 31 of Standards Board, Accounting and Financial Reporting for Certain Investments and for External Investment Pools.

Restricted for Investment Programs fund balance as reported June 30, 1996	$14,954,388
Recording of unrealized net change in portfolio value in accordance with GASB 31	102,640
Restricted for Investment Programs fund balance as restated June 30, 1996	$15,057,028

BOARD OF DIRECTORS

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Chairman and CEO
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Iandiorio & Teska

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Executive Assistant and
Office Operations Manager

Marie B. Phaneuf
Public Information Officer

Mary E. Stack
Accounting and Portfolio Data Assistant

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